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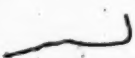
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Appendix

Internal Revenue Code of 1954:

SEC. 301. DISTRIBUTIONS OF PROPERTY.

(a) **IN GENERAL.**—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317 (a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(b) AMOUNT DISTRIBUTED.—

(1) **GENERAL RULE.**—For purposes of this section, the amount of any distribution shall be—

(A) **NONCORPORATE DISTRIBUTEES.**—If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.

(B) **CORPORATE DISTRIBUTEES.**—If the shareholder is a corporation, the amount of money received, plus whichever of the following is the lesser:

(i) the fair market value of the other property received; or

(ii) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the other property received, increased in the amount of gain to the distributing corporation which is recognized under subsection (b) or (c) of section 311, under section 341(f), or under section 1245(a) or 1250(a).

(C) **CERTAIN CORPORATE DISTRIBUTEES OF FOREIGN CORPORATION.**—Notwithstanding subparagraph (B), if the shareholder is a corporation and the distributing corporation is a foreign corporation, the amount taken into account with respect to property (other than money) shall be the fair market value of such property; except that if any deduction is allowable under section 245 with respect to such distribution, then the amount taken into account shall be the sum (determined under regulations prescribed by the Secretary or his delegate) of—

(i) the proportion of the adjusted basis of such property (or, if lower, its fair market value) properly attributable to gross income from sources within the United States, and

(ii) the proportion of the fair market value of such property properly attributable to gross income from sources without the United States.

(2) **REDUCTION FOR LIABILITIES.**—The amount of any distribution determined under paragraph (1) shall be reduced (but not below zero) by—

(A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution, and

(B) the amount of any liability to which the property received by the shareholder is subject immediately before, and immediately after, the distribution.

(3) **DETERMINATION OF FAIR MARKET VALUE.**—For purposes of this section, fair market value shall be determined as of the date of the distribution.

(c) **AMOUNT TAXABLE.**—In the case of a distribution to which subsection (a) applies—

(1) **AMOUNT CONSTITUTING DIVIDEND.**—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) **AMOUNT APPLIED AGAINST BASIS.**—That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) **AMOUNT IN EXCESS OF BASIS.**—

(A) **IN GENERAL.**—Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) **DISTRIBUTIONS OUT OF INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.**—That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value accrued before March 1, 1913, shall be exempt from tax.

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SEC. 351. TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.

(a) **GENERAL RULE.**—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange

such person or persons are in control (as defined in section 368 (c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

(b) **RECEIPT OF PROPERTY.**—If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock or securities permitted to be received under subsection (a), other property or money, then—

(1) gain (if any) to such recipient shall be recognized, but not in excess of—

(A) the amount of money received, plus

(B) the fair market value of such other property received; and

(2) no loss to such recipient shall be recognized.

(c) **SPECIAL RULE.**—In determining control, for purposes of this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account.

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SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) **GENERAL RULE.**—

(1) **IN GENERAL.**—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securi-

ties in such corporation or in another corporation a party to the reorganization.

(2) **LIMITATION.**—Paragraph (1) shall not apply if—

(A) the principal amount of any such securities received exceeds the principal amount of any such securities surrendered, or

(B) any such securities are received and no such securities are surrendered.

(3) **CROSS REFERENCE.**—

For treatment of the exchange if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

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SEC. 355. DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION.

(a) **EFFECT ON DISTRIBUTEEES.**—

(1) **GENERAL RULE.**—If—

(A) a corporation (referred to in this section as the “distributing corporation”)—

(i) distributes to a shareholder, with respect to its stock, or

(ii) distributes to a security holder, in exchange for its securities, solely stock or securities of a corporation (referred to in this section as “controlled corporation”) which it controls immediately before the distribution,

(B) the transaction was not used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (but the mere fact that subsequent to the distribution stock or securities in one or more of such corporations are sold or exchanged by all or some of the distributees (other than pursuant to an arrangement negotiated or agreed upon prior to such distribution) shall not be construed to mean that the transaction was used principally as such a device),

(C) the requirements of subsection (b) (relating to active businesses) are satisfied, and

(D) as part of the distribution, the distributing corporation distributes—

(i) all of the stock and securities in the controlled corporation held by it immediately before the distribution, or

(ii) an amount of stock in the controlled corporation constituting control within the meaning of section 368 (c), and it is established to the satisfaction of the Secretary or his delegate that the retention by the distributing corporation of stock (or stock and securities) in the controlled corporation was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax,

then no gain or loss shall be recognized to (and no amount shall be includible in the income of) such shareholder or security holder on the receipt of such stock or securities.

(2) **NON PRO RATA DISTRIBUTIONS, ETC.**—Paragraph (1) shall be applied without regard to the following:

(A) whether or not the distribution is pro rata with respect to all of the shareholders of the distributing corporation,

(B) whether or not the shareholder surrenders stock in the distributing corporation, and

(C) whether or not the distribution is in pursuance of a plan of reorganization (within the meaning of section 368 (a) (1) (D)).

(3) **LIMITATION.**—Paragraph (1) shall not apply if—

(A) the principal amount of the securities in the controlled corporation which are received exceeds the principal amount of the securities which are surrendered in connection with such distribution, or

(B) securities in the controlled corporation are received and no securities are surrendered in connection with such distribution.

For purposes of this section (other than paragraph (1) (D) of this subsection) and so much of section 356 as relates to this section, stock of a controlled corporation acquired by the distributing corporation by reason of any transaction which occurs within 5 years of the distribution of such stock and in which gain or loss was recognized in whole or in part, shall not be treated as stock of such controlled corporation, but as other property.

(4) CROSS REFERENCE.—

For treatment of the distribution if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

(b) REQUIREMENTS AS TO ACTIVE BUSINESS.—

(1) IN GENERAL.—Subsection (a) shall apply only if either—

(A) the distributing corporation, and the controlled corporation (or, if stock of more than one controlled corporation is distributed, each of such corporations), is engaged immediately after the distribution in the active conduct of a trade or business, or

(B) immediately before the distribution, the distributing corporation had no assets other than stock or securities in the controlled corporations and each of the controlled corporations is engaged immediately after the distribution in the active conduct of a trade or business.

(2) DEFINITION.—For purposes of paragraph (1), a corporation shall be treated as engaged in the active conduct of a trade or business if and only if—

(A) it is engaged in the active conduct of a trade or business, or substantially all of its assets consist of stock and securities of a corporation controlled by it (immediately after the distribution) which is so engaged,

(B) such trade or business has been actively conducted throughout the 5-year period ending on the date of the distribution,

(C) such trade or business was not acquired within the period described in subparagraph (B) in a transaction in which gain or loss was recognized in whole or in part, and

(D) control of a corporation which (at the time of acquisition of control) was conducting such trade or business—

(i) was not acquired directly (or through one or more corporations) by another corporation within the period described in subparagraph (B), or

(ii) was so acquired by another corporation within such period, but such control was so acquired only by reason of transactions in which gain or loss was not recognized in whole or in part, or only by reason of such transactions combined with acquisitions before the beginning of such period.

SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) GAIN ON EXCHANGES.—

(1) RECOGNITION OF GAIN.—If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354

or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) **TREATMENT AS DIVIDEND.**—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

(b) **ADDITIONAL CONSIDERATION RECEIVED IN CERTAIN DISTRIBUTIONS.**—If—

(1) section 355 would apply to a distribution but for the fact that

(2) the property received in the distribution consists not only of property permitted by section 355 to be received without the recognition of gain, but also of other property or money,

then an amount equal to the sum of such money and the fair market value of such other property shall be treated as a distribution of property to which section 301 applies.

(c) **Loss.**—If—

(1) section 354 would apply to an exchange, or section 355 would apply to an exchange or distribution, but for the fact that

(2) the property received in the exchange or distribution consists not only of property permitted by section 354 or 355 to be received without the recognition of gain or loss, but also of other property or money,

then no loss from the exchange or distribution shall be recognized.

(d) **SECURITIES AS OTHER PROPERTY.**—For purposes of this section—

(1) **IN GENERAL.**—Except as provided in paragraph (2), the term “other property” includes securities.

(2) **EXCEPTIONS.**—

(A) **SECURITIES WITH RESPECT TO WHICH NON-RECOGNITION OF GAIN WOULD BE PERMITTED.**—The term “other property” does not include securities to the extent that, under section 354 or 355, such securities would be permitted to be received without the recognition of gain.

(B) **GREATER PRINCIPAL AMOUNT IN SECTION 354 EXCHANGE.**—If—

(i) in an exchange described in section 354 (other than subsection (c) thereof), securities of a corporation a party to the reorganization are surrendered and securities of any corporation a party to the reorganization are received, and

(ii) the principal amount of such securities received exceeds the principal amount of such securities surrendered,

then, with respect to such securities received, the term "other property" means only the fair market value of such excess. For purposes of this subparagraph and subparagraph (C), if no securities are surrendered, the excess shall be the entire principal amount of the securities received.

(C) GREATER PRINCIPAL AMOUNT IN SECTION 355 TRANSACTION.—If, in an exchange or distribution described in section 355, the principal amount of the securities in the controlled corporation which are received exceeds the principal amount of the securities in the distributing corporation which are surrendered, then, with respect to such securities received, the term "other property" means only the fair market value of such excess.

(e) EXCHANGES FOR SECTION 306 STOCK.—Notwithstanding any other provision of this section, to the extent that any of the other property (or money) is received in exchange for section 306 stock, an amount equal to the fair market value of such other property (or the amount of such money) shall be treated as a distribution of property to which section 301 applies.

(f) TRANSACTIONS INVOLVING GIFT OR COMPENSATION.—For special rules for a transaction described in section 354, 355, or this section, but which—

(1) results in a gift, see section 2501 and following, or

(2) has the effect of the payment of compensation, see section 61(a)(1).

Income Tax Regulations:

Sec. 1.301-1. Rules applicable with respect to distributions of money and other property.

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(j) *Transfers for less than fair market value.* If property is transferred by a corporation to a shareholder which is not a corporation for an amount less than its fair market value in a sale or exchange, such shareholder shall be treated as having received a distribution to which section 301 applies. In such case, the amount of the distribution shall be the difference between the amount paid for the property and its fair market value. If property is transferred in a sale or exchange by a corporation to a shareholder which is a corporation, for an amount less than its fair market value and also less than its adjusted basis, such shareholder shall be treated as having received a distribution to which section 301 applies, and—

(1) Where the fair market value of the property equals or exceeds its adjusted basis in the hands of the distributing corporation the amount of the distribution shall be the excess of the adjusted basis over the amount paid for the property;

(2) Where the fair market value of the property is less than its adjusted basis in the hands of the distributing corporation, the amount of the distribution shall be the excess of such fair market value over the amount paid for the property.

If property is transferred in a sale or exchange after December 31, 1962, by a foreign corporation to a shareholder which is a corporation for an amount less than the

amount which would have been computed under paragraph (n) of this section if such property had been received in a distribution to which section 301 applied, such shareholder shall be treated as having received a distribution to which section 301 applies, and the amount of the distribution shall be the excess of the amount which would have been computed under paragraph (n) of this section with respect to such property over the amount paid for the property. In all cases, the earnings and profits of the distributing corporation shall be decreased by the excess of the basis of the property in the hands of the distributing corporation over the amount received therefor. In computing gain or loss from the subsequent sale of such property, its basis shall be the amount paid for the property increased by the amount of the distribution.

(k) *Application of rule respecting transfers for less than fair market value.* The application of paragraph (j) of this section may be illustrated by the following examples:

Example (1). On January 1, 1955, A, an individual shareholder of Corporation X, purchased property from that corporation for \$20. The fair market value of such property was \$100, and its basis in the hands of Corporation X was \$25. The amount of the distribution determined under section 301(b) is \$80. If A were a corporation, the amount of the distribution would be \$5, the excess of the basis of the property in the hands of Corporation X over the amount received therefor. The basis of such property to Corporation A would be \$25. If the basis of the property in the hands of Corporation X were

\$10, the corporate shareholder, A, would not receive a distribution. The basis of such property to Corporation A would be \$20. Whether or not A is a corporation, the excess of the amount paid over the basis of the property in the hands of Corporation X (\$20 over \$10) would be a taxable gain to Corporation X.

Example (2). On January 1, 1963, corporation A, which is a shareholder of corporation B (a foreign corporation engaged in business within the United States), purchased one share of corporation X stock from B for \$20. The fair market value of the share was \$100, and its adjusted basis in the hands of B was \$25. Assume that if the share of corporation X stock had been received by A in a distribution to which section 301 applied, the amount of the distribution under paragraph (n) of this section would have been \$55. The amount of the distribution under section 301 is \$35, i.e., \$55 (amount computed under paragraph (n) of this section) minus \$20 (amount paid for the property). The basis of such property to A is \$55.

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Sec. 1.351-1. Transfer to corporation controlled by transferor.

(a)(1) Section 351(a) provides, in general, for the non-recognition of gain or loss upon the transfer by one or more persons of property to a corporation solely in exchange for stock or securities in such corporation, if immediately after the exchange, such person or persons are in control of the corporation to which the property was transferred. As used in section 351, the phrase "one or more persons" includes individuals, trusts, estates, partnerships, associations, companies, or corporations (see

section 7701(a)(1)). To be in control of the transferee corporation, such person or persons must own immediately after the transfer stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such corporation (see section 368(c)). In determining control under this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account. The phrase "immediately after the exchange" does not necessarily require simultaneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure. For purposes of this section—

(i) stock or securities issued for services rendered or to be rendered to or for the benefit of the issuing corporation will not be treated as having been issued in return for property, and

(ii) stock or securities issued for property which is of relatively small value in comparison to the value of the stock and securities already owned (or to be received for services) by the person who transferred such property, shall not be treated as having been issued in return for property if the primary purpose of the transfer is to qualify under this section the exchanges of property by other persons transferring property. For the purpose of section 351, stock rights or stock warrants are not included in the term "stock or securities."

(2) The application of section 351(a) is illustrated by the following examples:

Example (1). C owns a patent right worth \$25,000 and D owns a manufacturing plant worth \$75,000. C and D organize the R Corporation with an authorized capital stock of \$100,000. C transfers his patent right to the R Corporation for \$25,000 of its stock and D transfers his plant to the new corporation for \$75,000 of its stock. No gain or loss to C or D is recognized.

Example (2). B owns certain real estate which cost him \$50,000 in 1930, but which has a fair market value of \$200,000 in 1955. He transfers the property to the N Corporation in 1955 for 78 percent of each class of stock of the corporation having a fair market value of \$200,000, the remaining 22 percent of the stock of the corporation having been issued by the corporation in 1940 to other persons for cash. B realized a taxable gain of \$150,000 on this transaction.

Example (3). E, an individual, owns property with a basis of \$10,000 but which has a fair market value of \$18,000. E also had rendered services valued at \$2,000 to Corporation F. Corporation F has outstanding 100 shares of common stock all of which are held by G. Corporation F issues 400 shares of its common stock (having a fair market value of \$20,000) to E in exchange for his property worth \$18,000 and in compensation for the services he has rendered worth \$2,000. Since immediately after the transaction, E owns 80 percent of the outstanding stock of Corporation F, no gain is recognized upon the exchange of the property for the stock. However, E realized \$2,000

of ordinary income as compensation for services rendered to Corporation F.

(b)(1) Where property is transferred to a corporation by two or more persons in exchange for stock or securities, as described in paragraph (a) of this section, it is not required that the stock and securities received by each be substantially in proportion to his interest in the property immediately prior to the transfer. However, where the stock and securities received are received in disproportion to such interest, the entire transaction will be given tax effect in accordance with its true nature, and in appropriate cases the transaction may be treated as if the stock and securities had first been received in proportion and then some of such stock and securities had been used to make gifts (section 2501 and following), to pay compensation (section 61(a)(1)), or to satisfy obligations of the transferor of any kind.

(2) The application of paragraph (b)(1) of this section may be illustrated as follows:

Example (1). Individuals A and B, father and son, organize a corporation with 100 shares of common stock to which A transfers property worth \$8,000 in exchange for 20 shares of stock, and B transfers property worth \$2,000 in exchange for 80 shares of stock. No gain or loss will be recognized under section 351. However, if it is determined that A in fact made a gift to B, such gift will be subject to tax under section 2501 and following. Similarly, if B had rendered services to A (such services having no relation to the assets transferred or to the business of the corporation) and the disproportion in the amount of stock

received constituted the payment of compensation by A to B, B will be taxable upon the fair market value of the 60 shares of stock received as compensation for services rendered, and A will realize gain or loss upon the difference between the basis to him of the 60 shares and their fair market value at the time of the exchange.

Example (2). Individuals C and D each transferred, to a newly organized corporation, property having a fair market value of \$4,500 in exchange for the issuance by the corporation of 45 shares of its capital stock to each transferor. At the same time, the corporation issued to E, an individual, 10 shares of its capital stock in payment for organizational and promotional services rendered by E for the benefit of the corporation. E transferred no property to the corporation. C and D were under no obligation to pay for E's services. No gain or loss is recognized to C or D. E received compensation taxable as ordinary income to the extent of the fair market value of the 10 shares of stock received by him.

Sec. 1.351-2. Receipt of property.

(a) If an exchange would be within the provisions of section 351(a) if it were not for the fact that the property received in exchange consists not only of property permitted by such subsection to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property. No loss to the recipient shall be recognized.

(b) See section 357 and the regulations pertaining to that section for applicable rules as to the treatment of liabilities as "other property" in cases subject to section 351, where another party to the exchange assumes a liability, or acquires property subject to a liability.

(c) See sections 358 and 362 and the regulations pertaining to those sections for applicable rules with respect to the determination of the basis of stock, securities, or other property received in exchanges subject to section 351.

(d) See Part I (section 301 and following), subchapter C, chapter 1 of the Code, and the regulations thereunder for applicable rules with respect to the taxation of dividends where a distribution by a corporation of its stock or securities in connection with an exchange subject to section 351(a) has the effect of the distribution of a taxable dividend.

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Sec. 1.355-1. Distribution of stock and securities of controlled corporation.

(a) *Application of section.* Section 355 provides for the separation, without recognition of gain or loss to the shareholders and security holders, of two or more existing businesses formerly operated, directly or indirectly, by a single corporation. It applies only to the separation of existing businesses which have been in active operation for at least five years, and which, in general, have been owned for at least five years by the corporation making the distribution of stock or of stock and securities. Section 355 does not apply to the division of a single business.

For the purpose of section 355, stock rights or stock warrants are not included in the term 'stock and securities'.

(b) *Types of separations.* Section 355 is concerned with two general types of separations of businesses. The first is the distribution of the stock of an existing corporation. The second is the distribution of the stock of a new corporation which stock was received in exchange for the assets of a business previously operated by the distributing corporation. In both cases, this section contemplates the continued operation of the businesses existing prior to the separation.

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Sec. 1.355-2. Limitations.

(a) *Property distributed.* The property distributed must consist solely of stock or stock and securities of a controlled corporation. If additional property (including an excess principal amount of securities received over securities surrendered) is received, see section 356.

(b) *Distribution of earnings and profits.* (1) The transaction must not have been used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corporation or of both. If, pursuant to an arrangement negotiated or agreed upon prior to the distribution of stock or securities of the controlled corporation, part or all of the stock or securities of either corporation are sold or exchanged after the distribution, such sale or exchange will be evidence that the transaction was used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corpo-

ration, or both. However, if the rules respecting continuity of interest contained in paragraph (c) of this section are not met, section 355 will not apply. If a sale of such stock or securities is made after the distribution and is not pursuant to an arrangement negotiated or agreed upon prior to the distribution, the mere fact of such sale is not determinative that the transaction was used principally as a device for the distribution of earnings and profits, but such fact will be evidence that the transaction was used principally as such a device.

(2) A sale is pursuant to an arrangement agreed upon prior to the distribution when enforceable rights to buy or to sell exist before such distribution. In any case in which a sale or exchange was discussed by the buyer and the seller before the distribution, but enforceable rights to buy or to sell did not exist before such distribution, the question whether an arrangement was negotiated within the meaning of section 355(a)(1)(B) shall be determined from all the facts and circumstances.

(3) In determining whether a transaction was used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corporation or both, consideration will be given to all of the facts and circumstances of the transaction. In particular, consideration will be given to the nature, kind and amount of the assets of both corporations (and corporations controlled by them) immediately after the transaction. The fact that at the time of the transaction substantially all of the assets of each of the corporations involved are and have been used in the active conduct of trades or businesses which meet the requirements of sec-

tion 355(b) will be considered evidence that the transaction was not used principally as such a device.

(c) *Business purpose.* The distribution by a corporation of stock or securities of a controlled corporation to its shareholders with respect to its own stock or to its security holders in exchange for its own securities will not qualify under section 355 where carried out for purposes not germane to the business of the corporations. The principal reason for this requirement is to limit the application of section 355 to certain specified distributions or exchanges with respect to the stock or securities of controlled corporations incident to such readjustment of corporate structures as is required by business exigencies and which, in general, effect only a readjustment of continuing interests in property under modified corporate forms. Section 355 contemplates a continuity of the entire business enterprise under modified corporate forms and a continuity of interest in all or part of such business enterprise on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the distribution or exchange. All the requisites of business and corporate purposes described under § 1.368 must be met to exempt a transaction from the recognition of gain or loss under this section.

(d) *Stock and securities distributed.* The distributing corporation must distribute—

- (1) All of the stock and securities of the controlled corporation which it owns, or

- (2) At least an amount of the stock which constitutes control as defined in section 368(c). In such

case all, or any part, of the securities of the controlled corporation may be distributed.

Where a part of either the stock or securities is retained under (2), it must be established to the satisfaction of the Commissioner that such retention was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax. Ordinarily, the business reasons (as distinguished from the desire to make a distribution of the earnings and profits) which support a distribution of stock and securities of a controlled corporation under paragraph (c) of this section will require the distribution of all of the stock and securities. If the distribution of all of the stock and securities of a controlled corporation would be treated to any extent as a distribution of 'other property' under section 356, this fact does not tend to establish that the retention of any of such stock and securities is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax.

(e) *Principal amount of securities.* (1) Section 355(a)(1) is not applicable if the principal amount of securities received exceeds the principal amount of securities surrendered or if securities are received and no securities are surrendered. In such cases, see section 356.

(2) If only stock is received in a transaction to which section 355 is applicable, the principal amount of securities surrendered, if any, and the par or stated value of stock is not relevant to the application of such section. For example: All of the stock of Corporation A is owned by X, an individual, and securities in the principal amount

of \$100,000 which were issued by Corporation A are owned by Y, an individual. Corporation A distributes all of the stock of a controlled corporation to Y in exchange for his securities. The par or stated value of the stock of the controlled corporation is \$150,000. No gain or loss is recognized to Y upon the receipt of the stock of the controlled corporation.

(f) *Period of ownership.* (1) For the purposes of determining whether gain or loss will be recognized upon a distribution, stock of a controlled corporation acquired (in a transaction in which gain or loss is recognized, in whole or in part) within five years of the date of the distribution of such stock is treated as 'other property'. Section 355 does not apply to a transaction which includes a distribution of such stock. See section 356. The stock so acquired is 'stock', however, for the purpose of the requirements respecting the distribution of stock of such controlled corporation provided in section 355(a)(1)(D).

(2) Paragraph (f)(1) of this section may be illustrated by the following example:

Example. Corporation A has held 85 of the 100 outstanding shares of the stock of Corporation B for more than five years on the date of distribution. Six months before such date, it purchased 10 shares of such stock. If all of the stock of the controlled corporation owned by Corporation A is distributed, section 355 is not applicable to such distribution since the 10 shares would represent 'other property.' See, however, section 356. If, however, for proper business reasons it is decided to retain some of the stock of Corporation B, then the determination of

the amount of such stock which must be distributed under section 355(a)(1)(D) in order to constitute a distribution to which section 355 is applicable must be made by reference to all of the stock of the controlled corporation including the 10 shares acquired six months before such date and the 5 shares owned by others. Similarly, if, by the use of any agency, the distributing corporation acquires stock of the controlled corporation within five years of the date of distribution, for example, where another subsidiary purchases such stock, such stock will be treated as 'other property.' If Corporation A had held only 75 of the 100 outstanding shares of stock of Corporation B for more than five years on the date of distribution and had purchased the remaining 25 shares six months before such date, neither section 355 nor section 356 would be applicable.

(G) *Active businesses.* The rules of section 355(b) and § 1.355-4, relating to active businesses, must be satisfied.

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Sec. 1.1502-31. Bases of tax computation.

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(b) *Computations.* In the case of affiliated corporations which make, or are required to make, a consolidated return, and except as otherwise provided in the regulations under section 1502:

(1) *Taxable income.* The taxable income of each corporation shall be computed in accordance with the provisions covering the determination of taxable income of separate corporations, except:

(i) There shall be eliminated unrealized profits and losses in transactions between members of the affiliated group and dividend distributions from one member of the group to another member of the group (referred to in the regulations under section 1502 as intercompany transactions);

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(A separately bound record appendix contains additional portions of the record on review beyond those printed in Appendix B to petitioner's brief).